

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 252 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

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1. Whether Reporters of Local Papers may be allowed to see the judgements?
 2. To be referred to the Reporter or not?
 3. Whether Their Lordships wish to see the fair copy of the judgement?
 4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
 5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INCOME TAX

Versus

H.H. MAHARAJA FATESINGH FAMILYTRUST NO.1

Appearance:

MR MANISH R BHATT for Petitioner
MR KC PATEL for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

Date of decision: 07/01/97

ORAL JUDGEMENT

(Per R.K.Abichandani, J)

1. The Income Tax Appellate Tribunal, Ahmedabad Bench 'C' has referred the following two questions for the opinion of this Court:

1. "Whether on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that the provisions of Section 60 of the Income Tax Act, 1961 were not applicable to the facts of the case?"

2. "Whether on the facts and in the circumstances of the case the Tribunal was right in law in coming to the conclusion that the interest income earned by the beneficiaries of the assessee Trust were not liable to be included in the income of the assessee trust on the principle of constructive receipt?"

2. The reference relates to three assessment years, namely, 1976-77 to 1978-79. The assessee had objected to the inclusion in its total income of interest earned on deposits made by the beneficiaries in the hands of the assessee trust. The assessee is a private discretionary trust created on 28.2.1958 by H.H.Maharaja Fatesinghrao Gaekwad of Baroda for the benefit and maintenance of the descendants of Maharaja Sayajirao Gaekwad of Baroda, born before creation of the trust. As per the trust deed, for the period of ten years from the date of the deed or during the life time of the settlor, the trustees were required to accumulate the balance of interest, dividends and income and add the same to the corpus of the trust fund with a discretion to apply the whole or a part of the income or accumulation of income for the benefit and maintenance of the beneficiaries. After the expiry of the period of ten years, the trustees were to apply whole of the income for the benefit and maintenance of these beneficiaries. On the death of the settlor, they were required to divide the corpus of the trust fund together with the accumulations of income, if any, amongst the heirs of the settlor, according to the law of intestate succession applicable to Hindus. The manner in which the investments could be made of the trust fund was specified in clause (4) of the deed, which included keeping the monies in fixed or other deposits with any scheduled Bank or Banks. The trustees had a liberty to alter, vary or transfer the investments into enumerated nature of investments or others of similar nature. There was no specific provision in the trust deed empowering the trustees to make advances out of the trust fund to the beneficiaries. During the course of the assessment proceedings, however, it was noticed by the Income Tax Officer that the assessee trust had advanced interest

free loans to the beneficiaries. The beneficiaries having taken such loans in July and August 1975 had made investments which yielded interest to them. Before the amounts were advanced to the beneficiaries they fetched interest to the trustees, who had deposited them in a company. It appears that initially the loan amounts were deposited by the beneficiaries in a firm known as M/s Gaekwad Investors, which firm made investments in a company known as Gaekwad Investment Corporation (P) Limited. The interest received on such deposits by the firm was passed on to the beneficiaries. The Income Tax Officer in this background held that the interest amount earned by the beneficiaries from the loan amounts which were given to them by the assessee trust were in reality the income of the assessee trust. The assessee trust objected to inclusion of such interest amount in computing its total income on the ground that it had not received any income by way of interest from the loans given interest free to the beneficiaries, that the beneficiaries were in reality entitled to the benefit of any interest which may have been earned on these amounts in terms of the trust deed; that whatever was so earned by them by way of interest was taxed in their individual assessments and that the interest received by the beneficiaries as partners of the firm M/s Gaekwad Investors was disallowed in the firms assessment. As the amount was taxed in the hands of the firm also, it could not be taxed in more than one hand. The Income Tax Officer did not accept these objections and held that this was a case of diversion of interest income to the beneficiaries who were not entitled to be given any interest free loan. The Assistant Commissioner of Income Tax upholding the orders of the Income Tax Officer held that the trustees were not empowered to invest and squander away the income of the trust to the detriment of the trust and that the Income Tax Officer was justified in taxing the income in the hands of the assessee trust to whom it legitimately belonged.

3. The Income Tax Appellate Tribunal while deciding the assessee's appeals in respect of these three assessment years held that inclusion of income from interest in the hands of the trustees was not justified. It was held that even if the trustees had no authority to make such advances, the income from such advances could not be said to have accrued to the trustees. According to the Tribunal, the provisions of Section 60 of the Income Tax Act, 1961 were not applicable to the facts of the case and the interest income earned by the beneficiaries could therefore not be included in the income of the assessee trust on the principle of

constructive receipt. The assessee's appeals were therefore allowed which led to referring of the aforesaid two questions for the opinion of this court at the instance of the revenue.

4. It was contended on behalf of the revenue that the amount of interest earned from loans which were given by the trustees to the beneficiaries should be treated as a constructive receipt of income of the trust, and that by adopting this arrangement the assessee nonetheless remained liable for the income that accrued by investing the said amounts. It was also contended that the trustees had no authority to advance such loans inasmuch as the trust deed was specific about the manner in which the monies could be invested which did not include making of such advances and that too interest free loans. It was contended that since the trustees had acted beyond their authority in advancing loans to the beneficiaries, the income arising from such amounts should be treated as income of the assessee trust. It was further contended that Section 60 of the said Act was applicable to the instant case inasmuch as the income was transferred to the beneficiaries by virtue of the loan arrangements and there was no transfer of the corpus.

5. The short question that arises for our consideration is as to whether the interest earned by the beneficiaries from the investments made by them out of the loan amounts which were given to them by the assessee trust could be included as income in the hands of the assessee trust.

6. Under clause (4) of the trust deed, it was specified as to how the monies were to be invested by the trustees. They could have invested the monies in the investments enumerated in clause (a) to (f) in stocks, funds, shares and securities or in fixed deposits in scheduled bank or banks or in the purchase, acquisition or mortgage of any immovable property or properties of any tenure including leaseholds. The trustees were at liberty to make investments of similar nature. It is therefore clear that the trustees could not have advanced any loans, to the beneficiaries much less interest free loans which were not at all warranted by the trust deed and could not be termed as investments. The trustees therefore acted de hors the provisions of the deed. However, that cannot by itself be a ground for the department to contend that the income derived from the interest free loans which were invested by the beneficiaries should be treated as income of the assessee trust. Section 5 of the said Act brings to charge income

from whatever source derived which is received or deemed to be received in India in a previous year by or on behalf of an assessee. The concept of deemed income would be limited to statutory income or the income which is so treated by operation of the Act. There is no provision by which the income derived by the beneficiaries from the loans which were advanced to them by the assessee trust could be treated as deemed income of the assessee trust. The income can be said to be constructively received by some other person on behalf of the assessee if the assessee has a domain over such receipt, such as, in case of receipt of income by an agent of the assessee, or by a person under the authority of the assessee. In the instant case, the assessee trust had made interest free advances to the beneficiaries and there was no stipulation that they would pay any earnings out of the loan amount to the assessee trust. Merely because the beneficiaries had invested the amounts which they were given as interest free loan and earned income by way of interest the trustees did not become entitle to claim such earnings. The investments were made by the beneficiaries in their own right and not as the agents of the assessee trust. Therefore, the income derived by the beneficiaries from their own investments could not be regarded as income received by or on behalf of the trustees. In our view therefore, the Tribunal rightly held that the principle of constructive receipt could not be invoked by the revenue authority for justifying its stand to include the interest income earned by the beneficiaries in the hands of the trustees.

7. The provisions of Section 60 which fall for our consideration read as under:

"All income arising to any person by virtue of a transfer whether revocable or not and whether effected before or after the commencement of this Act shall, where there is no transfer of the assets from which the income arises, be chargeable to income tax as the income of the transferor and shall be included in his total income."

The expression "the income arising to any person by virtue of a transfer" in Section 60 indicates that the income in question should arise by virtue of the transfer itself. The word, 'transfer' has been defined for the purposes of Sections 60, 61 and 62, in Section 63, so as to include any settlement, trust, determination, agreement or arrangement. Therefore, though a loan transaction can be termed as an agreement or arrangement

and therefore a 'transfer' within the meaning of Section 63(b), the income derived by the beneficiaries by their own investments of such loan amount cannot be said to be income arising to them by virtue of the loan transaction itself. The beneficiaries could have used the loan amounts in any manner they wanted including by investing them in business or depositing them in bank or banks. The income that they derived by such investments had no direct nexus with the original loan transaction. In other words, the interest income did not accrue to the beneficiaries by virtue of the transaction of loan, but it accrued to them by virtue of the subsequent transactions of their having invested the amounts. It is therefore clear that the provisions of Section 60 of said Act could not have been invoked by the revenue for assessing the income of the beneficiaries in the hands of the assessee trust. The Tribunal was therefore justified in holding that the provisions of Section 60 were not applicable to the facts of the present case.

8. In the above circumstances, both the questions referred to this Court are answered in the affirmative in favour of the assessee and against the revenue. Reference stands disposed of accordingly with no order as to costs.
